# RESEARCH NOTE

#PARG 2020-04RN

# Investor Perspective on Impression Management in Earnings Press Releases: Insights from TSX Venture Exchange Firms

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Firms use various corporate disclosure documents to communicate valuable incremental information to their investors about the firm's performance. Firms also use these documents opportunistically to manage or influence the perceptions of investors. This opportunistic behavior of firms in their disclosure documents is often referred to as impression management which, is a rapidly growing field of research in accounting. However, there is still little known about impression management practices of small, low-visibility firms. Moreover, there is lack of research on retail investors' direct attention to impression management strategies as prior research has mainly focused on stock market reaction.

This study[1] analyzes several impression management strategies in the earnings press releases of TSX Venture Exchange firms to investigate whether, and how, low-visibility firms engage in impression management. It also explores the investor reaction to impression management strategies by supplementing stock market reaction with online investment discussion board reaction. This note is part of a sequence of three research notes. The first note (#PARG 2020-02RN) is about impression management strategies. The second note (#PARG 2020-03RN) is about firm perspective on impression management and provides findings on impression management practices of TSX Venture Exchange firms. The third note (#PARG 2020-04RN) is about investor perspective on impression management and shares findings on the consequences for investors of the use of various impression management strategies.



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**Two measures of investor reaction**

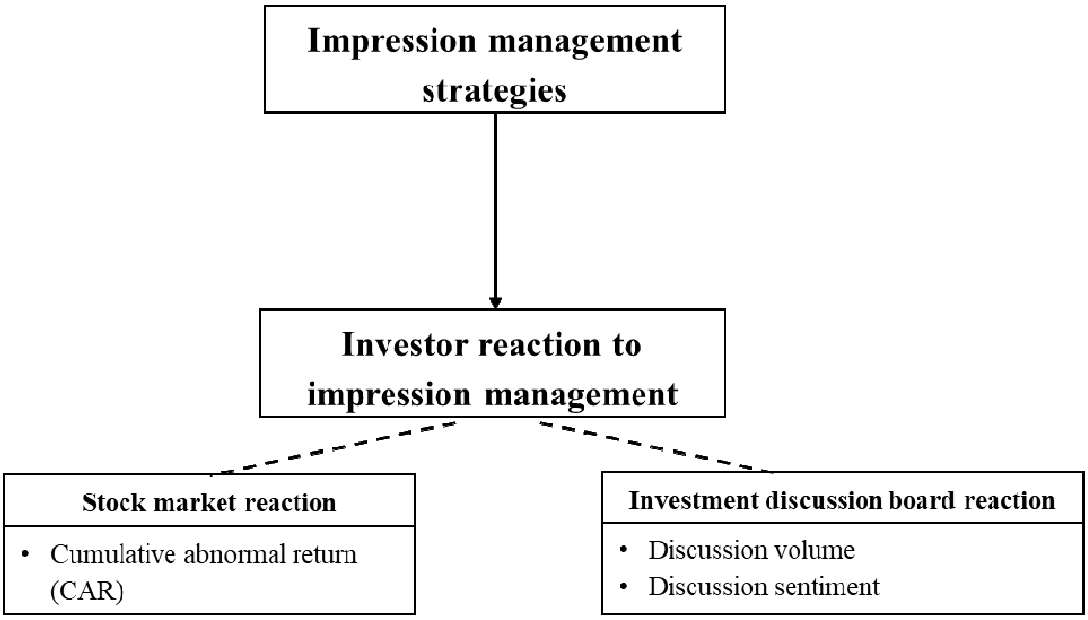
Firms' engagement in impression management would be pointless if these strategies were not intended to affect the views of others. Investors, including potential investors, comprise the major group of users who are targeted by firms when managing impressions. The success or failure of firms' strategies to opportunistically manage the content of their disclosures is largely dependent on how investors react to such strategies. Therefore, studying this investor reaction – the investor perspective - can help provide insights into various consequences of impression management.
A growing body of accounting and finance research has examined investor reaction to impression management strategies in disclosure documents. Prior research has studied investor reaction largely from the point of stock market response, and the focus has so far been on tone management. The majority of these studies find that positive tone creates an excessively optimistic short window, usually three-day, stock response (Henry, 2008; Davis, Piger and Sedor, 2012; Arslan-Ayaydin, Boudt and Thewissen, 2016). Those results confirm a consensus among most researchers that disclosure tone influences investors' judgement regarding a firm's value in the short run.

While most prior studies have concentrated on how disclosure tone influences investor reaction, some researchers have also investigated how other impression management strategies are associated with investor reaction. In particular, prior literature has mainly explored how manipulating readability and other rhetorical features of disclosure documents affects stock market reaction. Overall, these manipulation or obfuscation efforts by firms often lead to a positive reaction from investors, at least in the short term. However, there is limited research that offers a holistic view of investor reaction by examining several impression management strategies in disclosure documents together.

Moreover, aside from a very few experimental studies, there is no impression management research that investigates investors' direct reactions to firm disclosures, which can possibly be timelier than stock market reaction. In addition to examining stock market reaction, the current study uses online investment discussion board data to explore retail investors' direct response to impression management strategies. More specifically, online discussion volume and sentiment measures are used to examine how retail investors react to various impression management strategies used in EPRs of TSX Venture Exchange firms. Therefore, the objective of this research is to better understand retail investor perceptions, as well as complement stock market studies with more direct measures of retail investor reaction to impression management strategies.

Figure 1 briefly illustrates that the investigation of investor response to impression management strategies is twofold: (1) stock market reaction and (2) investment discussion board reaction. Each component is designed to provide insights on investor reaction to impression management that are different in what they measure, yet are similar in that they explore investor reaction to impression management in general.

Figure 1 - Investor reaction to apparent impression management




**Research questions**

This study measures impression management in 1,317 earnings press releases (EPRs) from 145 TSX Venture firms to understand how investors react to apparent impression management strategies. For investor reaction data, the study uses stock market data and several hundred thousand online investment discussion board posts from Stockhouse.com, which is one of North America's top investment discussion communities.

There are two questions that this study sought to answer:

1. What, if any, is the relationship between impression management strategies and stock returns?
2. What, if any, is the relationship between impression management strategies and online investment discussion board reaction?

Exploring these questions can yield complementary findings on investor behavior in response to apparent impression management. For example, stock market reaction helps analyze the impact of impression management on stock price, while investment discussion board response helps analyze investor attention and perceptions towards apparent impression management.

For the investigation of stock market reaction, this study builds on prior literature that uses the event study methodology by analyzing cumulative abnormal return (CAR) as the response variable. For the investigation of investment discussion board reaction, since there is no prior literature, this study borrows from stock market reaction studies to design reaction or response constructs. More specifically, abnormal discussion volume (number of posts) and abnormal discussion sentiment (post tone) measures are calculated from the differences between event period (three-day window around the issuance of EPRs) and pre-event period numbers.

**Stock market reaction**

Stock market reaction results confirm the expectation that investors favorably respond to abnormal tone around the issuance of EPRs. However, the impact of abnormal tone dissipates in the 30-day window and becomes negative in the 60-day window. These findings are in line with prior literature on the effect of tone on CAR (Huang, Teoh and Zhang, 2014; Arslan-Ayaydin et al., 2016). Similar findings are generated for the impact of headline impression management. In particular, investors are positively influenced by thematic manipulation, reinforcement, and repetition strategies in EPR headlines, however this impact is not as strong in the 30-day window and is weak in the 60-day window.

Reading complexity and causal reasoning intensity were found to explain neither short-term nor longer-term CAR. These results are consistent with Henry (2008) who also found no impact of verbal complexity on stock market returns. Notable findings from the effects of control variables include strong associations for book-to-market and industry variables. Consistent with prior literature (Porta, Lakonishok, Shleifer and Vishny, 1997; Huang et al., 2014; Arslan-Ayaydin et al., 2016), the impact of impression management on the short-term CAR is greater for higher book-to-market firms, suggesting that market surprise is more positive when higher book-to-market firms engage in impression management. Industry results show firms that are not in natural resource industries experience lower CAR both around the issuance of EPRs and in the longer periods (30-day and 60-day windows).

**Investment discussion board reaction**

As more direct measures of retail investor reaction, online investment board discussion volume and sentiment were also examined in response to impression management strategies. For discussion volume reaction, results indicate that headline impression management was found to be the single most important predictor of abnormal discussion volume around the issue of EPRs. This finding suggests that investment discussion board participants may be ‘lazy’ investors who are drawn by impression management in EPR headlines and pay little or no attention to the content of EPRs. Abnormal tone was also found to positively impact discussion volume to some extent; however, this impact is not as strong as headline impression management. The effect of reading complexity is weak in the three-day window, but it becomes stronger in the 60-day window. A possible explanation is that online discussants, who were initially attracted to EPRs with inflated tone and emphasized headlines, are taking time to read and discuss EPRs with higher reading complexity.

For control variables, results indicate that EPRs of firms with negative earnings experience much higher discussion volume than positive earnings firms around the issue of EPRs. This finding is consistent with Lerman (2017) who finds that, for good performers, online discussion board participants are mainly interested in discussing the good earnings-related news, while for poor performers, participants also discuss other non-earnings-related news. These results, however, were largely different in the longer-term. In particular, in the 60-day window, the effects of headline impression management bias and abnormal tone become weaker, while reading complexity becomes stronger. These results suggest that in the longer-term online participants may dedicate more time to discussing harder-to-read EPRs which they initially avoided around the issuance of EPRs. These results also indicate that 60-day window discussion volume is higher when market returns are lower, suggesting that discussion board participants may be posting more due to being nervous or else seeking buying opportunities.

This study also explored the association between impression management strategies and discussion board sentiment. Overall, it was found that none of the impression management strategies explain online discussion sentiment. It is possible that, as suggested earlier, online discussion participants are 'lazy' investors who do not read through EPRs, making it difficult to estimate associations between their sentiment and impression management strategies. Another possible explanation may point to a limitation of this study in terms of measuring the sentiment in online discussion boards. Although this study uses extensive word lists based on three dictionaries, these lists may not be suited to fully capture the sentiment of online discussions due to the highly ambiguous nature these discussions (Das and Chen, 2007; Renault, 2017). Therefore, using a dictionary that is specifically designed to measure sentiment in online discussion boards could yield better results.

**Implications**

Findings of this study have implications for regulators, investors, and low-visibility public firms. Regulators may want to review or set rules around the presentation of performance results in EPRs or educate investors on the consequences of impression management by low-visibility firms. For example, findings of this study indicate that firms manage tone and manipulate readability in their EPRs, while investors show positive short-term reaction which subsides or reverses in the longer term. Equipped with this knowledge, financial regulators may find it necessary to prepare educational materials designed to increase investors' knowledge of impression management.

For investors, this research brings awareness to the short-term and the longer-term impacts of impression management strategies on stock price and investor perceptions, and may encourage greater engagement with the text in the body of EPRs, rather than just the headlines. For example, the strong positive association between headline impression management bias and online discussion volume in the three-day window may suggest that most retail investors are drawn to positively emphasized or 'catchy' headlines, as opposed to carefully reading the content of EPRs. This knowledge may help investors avoid focusing too much on headlines, which are very likely to be manipulated by firms as indicated by the results of this study.

Low-visibility public firms with different characteristics (e.g., firm size and industry) may want to better understand the consequences of managing their voluntary disclosures through impression management and the voluntary disclosure practices among their peers. Findings from both stock market reaction and investment discussion board reaction confirm impression management strategies have only a short-term, unsustainable impact on investors. Once informed about these and other consequences of various impression management strategies, low-visibility firms may decide not to opportunistically manage the content of their disclosures.

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**NOTES**

[1] Mansurov, Alisher. (2019). *Investor and Firm Perspectives on Impression Management in Earnings Press Releases: Insights from TSX Venture Exchange Firms*. (Doctoral Dissertation). Sprott School of Business, Carleton University, December. URL: https://carleton.ca/profbrouard/wp-content/uploads/ThesisPhDAlisherMansurov201912.pdf